Michigan Department of Treasury
496 (02/06)

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type	Local Unit Name	County
☐County ☐City ☐Twp ☐Village ☒Other	LifeWays	Jackson

Fiscal Year End	Opinion Date	Date Audit Report Submitted to State
September 30, 2006	December 15, 2006	March 30, 2007

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

	YES	NO	**Check each applicable box below**. (See instructions for further detail.)
1.	☒	☐	All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2.	☒	☐	There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3.	☒	☐	The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4.	☒	☐	The local unit has adopted a budget for all required funds.
5.	☒	☐	A public hearing on the budget was held in accordance with State statute.
6.	☒	☐	The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7.	☒	☐	The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8.	☒	☐	The local unit only holds deposits/investments that comply with statutory requirements.
9.	☒	☐	The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan,* as revised (see Appendix H of Bulletin).
10.	☒	☐	There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11.	☒	☐	The local unit is free of repeated comments from previous years.
12.	☒	☐	The audit opinion is UNQUALIFIED.
13.	☒	☐	The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14.	☒	☐	The board or council approves all invoices prior to payment as required by charter or statute.
15.	☒	☐	To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)
Financial Statements	☒	
The letter of Comments and Recommendations	☒	
Other (Describe)	☐	

Certified Public Accountant (Firm Name)	Telephone Number		
REHMANN ROBSON	517-787-6503		
Street Address	**City**	**State**	**Zip**
675 Robinson Road	Jackson	MI	49203

Authorizing CPA Signature	Printed Name	License Number
Mark Kettner	Mark T. Kettner, CPA, CGFM	11673

Financial Statements
For the Year Ended
September 30, 2006

LifeWays
paths for personal growth

Your First Pathway to

Behavioral Health Care

in Jackson and Hillsdale

REHMANN ROBSON

Certified Public Accountants

LifeWays
paths for personal growth

Jackson, Michigan

Financial Statements

For the Year Ended September 30, 2006

LifeWays

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REHMANN ROBSON
Certified Public Accountants
A member of THE REHMANN GROUP
an independent member of BAKER TILLY INTERNATIONAL

INDEPENDENT AUDITORS' REPORT

December 15, 2006

The Board of Directors
LifeWays
Jackson, Michigan

We have audited the accompanying financial statements of the business-type activities, the major fund, and the aggregate remaining fund information of ***LifeWays*** as of and for the year ended September 30, 2006, which collectively comprise LifeWays' basic financial statements as listed in the table of contents. These financial statements are the responsibility of LifeWays' management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities, the major fund, and the aggregate remaining fund information of LifeWays as of September 30, 2006, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 15, 2006, on our consideration of LifeWays' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

675 Robinson Road · P.O. Box 449 · Jackson, MI 49204 · Phone 517.787.6503 · Fax 517.788.8111 · www.rehmann.com

The Management's Discussion and Analysis and GASB Statement 25 supplementary information listed in the table of contents are not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and do not express an opinion on it.

Our audit was performed for the purpose of forming opinions on the financial statements that collectively comprise LifeWays' basic financial statements. The combining fund financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Rehmann Robson

MANAGEMENT'S DISCUSSION AND ANALYSIS

LifeWays
Management's Discussion and Analysis

As management and administrators of LifeWays, we offer readers of LifeWays' financial statements this narrative overview and analysis of the financial activities of LifeWays for the fiscal year ended September 30, 2006.

Overview of the Financial Statements

- Total assets of LifeWays amounted to $20,394,206 and total liabilities amounted to $14,318,352 on September 30, 2006.

- LifeWays total net assets decreased by $399,931 during the current year**.**

- As of the close of the current fiscal year, LifeWays' reported ending net assets of $6,075,854. Approximately 72% of this balance, or $4,385,562 is *available for spending* at LifeWays' discretion *(Operating Fund unrestricted net assets).* An additional 1%, or $64,935 is invested in capital assets, net of related debt. The remaining 27%, or $1,625,357, is to be held as a reserve against potential liabilities relative to and as allowed by its contract with the Michigan Department of Community Health (MDCH).

This discussion and analysis is intended to serve as an introduction to LifeWays' basic financial statements. LifeWays' basic financial statements are comprised of two components:

1) Government-wide/fund financial statements
2) Notes to the financial statements.

This report also contains other supplementary information in addition to the basic financial statements themselves.

Government-wide/Fund Financial Statements. As permitted by GASB Statement No. 34, LifeWays uses an alternative approach reserved for single program governments to present combined government-wide and fund financial statements. These financial statements are designed to provide readers with a broad overview of LifeWays' finances, in a manner similar to a private-sector business. This is done by reporting LifeWays' assets and liabilities using the full accrual method of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

The *Statement of Net Assets* presents information on all of LifeWays' assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of LifeWays is improving or deteriorating.

The *Statement of Activities and Proprietary Fund Revenue, Expenses and Changes in Fund Net Assets* presents information showing how LifeWays' revenue and expenses changed during the most recent fiscal year. All changes in revenue and expenses are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods. In addition, this statement discloses *non-cash* expenditures of depreciation and amortization, which affect the ending book value of capital assets.

The *Statement of Cash Flows* presents information about the source and usage of cash and cash equivalents and divides the information reported into three classifications: operating, financing, and investing. LifeWays' operations generate and use cash in the normal flow of activity: the collection of revenues and payments to contractors plus the non-cash activity add-backs such as depreciation. Financing activities include borrowing and repayment of long-term debt and purchase of equipment/group homes. Investing includes such items as investment of cash and other long-term assets.

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the government-wide/fund financial statements. The accompanying notes are an integral part of the financial statements and must be reviewed in conjunction with the information reported on the financial statements to provide a full understanding of LifeWays' financial situation.

Government-wide Financial Analysis

By far the largest portion of LifeWays' total assets ($10,622,375 or 52%) reflects its investment in capital asset at 1200 N West Avenue, group homes, equipment and furniture.

The second largest portion of LifeWays' total assets ($9,038,980 or 44%) reflects its cash and cash equivalents.

LifeWays' Total Assets & Net Assets

	2005	2006
Current and other assets	$ 10,104,684	$ 9,771,831
Capital assets, net	1,451,451	10,622,375
Total assets	**11,556,135**	**20,394,206**
Long-term liabilities outstanding	800,000	10,557,440
Other liabilities	4,280,350	3,760,912
Total liabilities	**5,080,350**	**14,318,352**
Net assets:		
Invested in capital assets, net of related debt	651,451	64,935
Restricted	2,025,288	1,625,357
Unrestricted	3,799,046	4,385,562
Total net assets	**$ 6,475,785**	**$ 6,075,854**

LifeWays' net assets decreased by $399,931 during the current fiscal year. This is largely due to a planned utilization of unrestricted fund balances to cover building acquisition and renovation costs at 1200 N West Avenue. A calculated executive decision was also made to invest more in delivering consumer services. In particular, LifeWays added $187,000 to funds available for providing substance abuse services.

LifeWays' Changes in Net Assets

	2005	2006
Operating revenue:		
MDCH Contract - Medicaid	$ 35,086,390	$ 35,619,763
Operating grants and contributions	1,344,707	2,244,461
Charges for services and other local revenue	417,705	755,976
	36,848,802	38,620,200
Operating expenses:		
Board administration	3,112,012	4,287,355
Mental health services	33,274,878	34,074,811
Substance abuse	446,309	650,919
Depreciation and amortization	154,875	191,431
	36,961,074	39,204,516
Operating income (loss)	**(112,272)**	**(584,316)**
Non-operating revenue (expense)		
Prior year cost settlement	-	(15,293)
Interest income	206,295	397,334
Interest expense	(46,950)	(197,656)
	159,345	184,385
Net income (loss)	**47,073**	**(399,931)**
Net assets, beginning of year	6,428,712	6,475,785
Net assets, end of year	**$ 6,475,785**	**$ 6,075,854**

Financial Analysis of LifeWays' Funds

As noted earlier, LifeWays uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Operating Fund LifeWays accounts for its primary operations in an enterprise fund which is accounted for on the same basis of accounting as the government-wide financial statements. Accordingly, a separate analysis is not included herein.

Internal Service Funds The focus of LifeWays' internal service funds is used to account for assets held as a reserve against potential liabilities relative to and allowed by its contract with the Michigan Department of Community Health (MDCH). LifeWays' risk management plan has been reviewed and approved by MDCH.

At the end of the current fiscal year, LifeWays' internal service funds had combined net assets of $1,625,357, a decrease of $399,931 in comparison with the prior year. LifeWays made an executive decision at the beginning of the year to reduce its fund balance and invest more in consumer services. The current balance in the ISF account is the bare minimum that LifeWays is required to maintain by contract with MDCH for management of Medicaid funds.

Explanation of Adjustments This is reflected as a reduction to both revenue and expense. In addition, interfund transfers related to the use of risk reserve internal service funds were eliminated in the amount of $484,263.

Capital Asset and Debt Administration

Capital assets. LifeWays' investment in capital assets for its activities as of September 30, 2006, amounted to $10,622,375 (net of accumulated depreciation of $1,328,813). This investment in capital assets includes the administrative and retail building, group homes, leasehold improvements, and equipment. Capital assets increased by $9,170,924 during the current fiscal year.

During the year under review, LifeWays purchased the property it occupies at 1200 N West Avenue. The company also undertook renovation work to the administrative office as well as the retail space.

Accumulated depreciation at September 30, 2006 amounted to $1,328,813 and included current year depreciation expense of $190,482.

LifeWays' Capital Assets
(Net of depreciation)
September 30, 2006

Land	$ 2,000,000
Construction in progress	1,000,162
Buildings	6,308,234
Computer equipment	36,670
Furnishings and other equipment	2,075
Leasehold improvements	530,150
Group homes	745,084
Total	**$10,622,375**

Long-term debt. At the end of the current fiscal year, LifeWays had general obligation bond and commercial mortgage debt outstanding of $10,557,440. The current portion of debt outstanding is $330,880. These bonds were issued to finance the acquisition of five group homes for providing residential services to LifeWays' consumers and to purchase and renovate LifeWays' office at 1200 N West Avenue. A mortgage in with an outstanding balance of $2,779,780 is held by Citizens Bank.

Factors Bearing on LifeWays' Future

The following factors were considered in preparing LifeWays' budget for the 2006-07 fiscal year:

- Increase costs associated with being a landlord for premises at 1200 N West Avenue.
- Increases in known and estimated costs – namely, energy, health insurance, workers' compensation insurance and salary increases.
- An increasing trend in Medicaid-eligible consumers and the uninsured population related to increased unemployment and a sluggish economy.
- Potential Federal and State Medicaid and general Funds cuts either through funding or service eligibility.
- New community service initiatives including:
  - ✓ Prisoner re-entry program
  - ✓ Service integration initiatives

Requests for Information

This financial report is designed to provide a general overview of LifeWays' finances for all those with an interest in LifeWays' finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Ivan Gibbs, Chief Finance Officer, LifeWays 1200 N. West Ave. Jackson, Michigan 49202.

BASIC FINANCIAL STATEMENTS

LifeWays
Statement of Net Assets
Proprietary Funds
September 30, 2006

	Enterprise Operating Fund	Internal Service Funds	Total Business-type Activities
Assets			
Cash and cash equivalents	$ 7,413,623	$ 1,625,357	$ 9,038,980
Receivables:			
Fees, net of allowance for doubtful accounts of $73,719	118,759	-	118,759
Due from Michigan Department of Community Health	349,732	-	349,732
Other	100,643	-	100,643
Prepaid items	72,629	-	72,629
Capital assets not being depreciated	3,000,162	-	3,000,162
Capital assets being depreciated, net	7,622,213	-	7,622,213
Unamortized bond issuance costs	91,088	-	91,088
Total assets	18,768,849	1,625,357	20,394,206
Liabilities			
Accounts payable	2,305,464	-	2,305,464
Due to Michigan Department of Community Health	372,474	-	372,474
Accrued liabilities	425,274	-	425,274
Claims incurred but not reported	566,469	-	566,469
Unearned revenue	91,231	-	91,231
Long-term debt:			
Due within one year	330,880	-	330,880
Due in more than one year	10,226,560	-	10,226,560
Total liabilities	14,318,352	-	14,318,352
Net assets			
Invested in capital assets, net of related debt	64,935	-	64,935
Restricted for contract losses	-	1,625,357	1,625,357
Unrestricted	4,385,562	-	4,385,562
Total net assets	$ 4,450,497	$ 1,625,357	$ 6,075,854

The accompanying notes are an integral part of these financial statements.

LifeWays
Statement of Activities and
Proprietary Fund Revenue, Expenses, and Changes in Fund Net Assets
For the Year Ended September 30, 2006

	Enterprise Operating Fund	Internal Service Funds	Adjustments	Total Business-type Activities
Operating revenue				
Medicaid capitation	$ 29,415,617	$ -	$ -	$ 29,415,617
State general fund indigent	6,204,146	-	-	6,204,146
Earned revenues, grants and federal programs	1,742,584	-	-	1,742,584
Substance abuse	501,877	-	-	501,877
Local revenue:				
County appropriations	94,136	-	-	94,136
Rental revenue	111,588	-	-	111,588
First party	11,060	-	-	11,060
Third party	494,956	-	-	494,956
Other local revenue	44,236	-	-	44,236
Total operating revenue	38,620,200	-	-	38,620,200
Operating expenses				
Board administration	4,287,355	-	-	4,287,355
Mental health services	34,074,811	-	-	34,074,811
Substance abuse	650,919	-	-	650,919
Depreciation and amortization	191,431	-	-	191,431
Total operating expenses	39,204,516	-	-	39,204,516
Operating loss	(584,316)	-	-	(584,316)
Non-operating revenue (expense)				
Prior year cost settlement	(15,293)	-	-	(15,293)
Interest income	313,002	84,332	-	397,334
Interest expense	(197,656)	-	-	(197,656)
Total non-operating revenue	100,053	84,332	-	184,385
Net income (loss) before transfers	(484,263)	84,332	-	(399,931)
Transfers in	484,263	-	(484,263)	-
Transfers out	-	(484,263)	484,263	-
Change in net assets	-	(399,931)	-	(399,931)
Net assets, beginning of year	4,450,497	2,025,288	-	6,475,785
Net assets, end of year	$ 4,450,497	$ 1,625,357	$ -	$ 6,075,854

The accompanying notes are an integral part of these financial statements.

LifeWays
Statement of Cash Flows
Proprietary Funds
For the Year Ended September 30, 2006

	Enterprise Operating Fund	Internal Service Funds
Cash flows from operating activities		
Cash received from customers and others	$ 38,623,346	$ -
Cash payments to employees	(2,263,237)	-
Cash payments to suppliers for goods and services	(37,100,270)	-
Net cash used in operating activities	(740,161)	-
Cash flows from capital and related financing activities		
Principal paid on bonds	(45,220)	-
Interest paid on bonds	(197,656)	-
Purchase of capital assets	(9,361,406)	-
Proceeds from long-term debt	9,723,923	-
Net cash provided by capital and related financing activities	119,641	-
Cash flows from non-capital financing activities		
Transfers in	484,263	-
Transfers out	-	(484,263)
Net cash provided by (used in) non-capital financing activities	484,263	(484,263)
Cash flows from investing activities		
Interest received	313,002	84,332
Net increase (decrease) in cash and cash equivalents	176,745	(399,931)
Cash and cash equivalents, beginning of year	7,236,878	2,025,288
Cash and cash equivalents, end of yea	$ 7,413,623	$ 1,625,357

continued…

LifeWays
Statement of Cash Flows
Proprietary Funds (Concluded)
For the Year Ended September 30, 2006

	Enterprise Operating Fund	Internal Service Funds
Reconciliation of operating income (loss) to net cash used in operating activities		
Operating loss	$ (584,316)	$ -
Adjustments to reconcile operating income (loss) to net cash used in operating activities:		
Depreciation and amortization	191,431	-
Prior year cost settlement	(15,293)	
Changes in assets and liabilities:		
Fees receivable	(88,540)	-
Due from Michigan Department of Community Health	(232,201)	-
Other receivables	365,711	-
Prepaid items	142,485	-
Accounts payable	1,012,638	-
Due to Michigan Department of Community Health	169,274	-
Accrued liabilities	(1,357,089)	-
Claims incurred but not reported	(317,730)	-
Unearned revenue	(26,531)	-
Net cash used in operating activities	$ (740,161)	$ -

The accompanying notes are an integral part of these financial statements.

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of **LifeWays**, a Community Mental Health Authority established under Section 205 of the Michigan Mental Health Code, have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The Government Accounting Standards Board (GASB) is the accepted standards-setting body for establishing governmental accounting and financial reporting principles. The more significant of LifeWays accounting policies are described below.

A. Reporting Entity

As indicated above, LifeWays is a Community Mental Health Authority serving the mental health needs of Jackson and Hillsdale County residents. Its Board of Directors is appointed by the County Commissions of Jackson and Hillsdale Counties.

B. Government-wide and Fund Financial Statements

As permitted by GASB Statement No. 34, LifeWays uses an alternative approach reserved for single program governments to present combined government-wide and fund financial statements by using a columnar format that reconciles individual line items of fund financial data to government-wide data in a separate column. Accordingly, this is presented in the Statement of Net Assets – Proprietary Funds and the Statement of Activities and Proprietary Fund Revenues, Expenses and Changes in Fund Net Assets. LifeWays' only major fund is reported in a separate column in the aforementioned financial statements.

The operations of LifeWays are accounted for as an Enterprise Fund (a proprietary fund) which is designed to be self-supporting. Enterprise Funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the cost of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

The Risk Reserve Funds (both of which are internal service funds, a proprietary fund type) are used to account for assets held as a reserve against potential liabilities relative to and as allowed by its contract with the Michigan Department of Community Health (MDCH). Pursuant to these contractual provisions, LifeWays' risk management plan has been reviewed and approved by MDCH. Separate risk reserves are maintained for mental health and substance abuse services.

C. Measurement focus, basis of accounting, and financial statement presentation

The government-wide and proprietary fund financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

The enterprise fund is LifeWays' primary operating fund, and only major fund. It accounts for all financial resources of the government, except those required to be accounted for in another fund.

Private sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in both the government-wide and proprietary fund financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. Governments also have the *option* of following subsequent private-sector guidance for their business-type activities and enterprise funds, subject to the same limitation. The government has elected not to follow subsequent private-sector guidance.

Proprietary funds distinguish *operating* revenues and expenses from *non-operating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of LifeWays' operating fund are contract revenues from MDCH and first and third party billings. Operating revenues of the internal service funds are primarily comprised of charges to other funds and governmental entities for risk financing. Operating expenses include the cost of providing mental health and substance abuse services. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

D. Assets, liabilities and equity

1. Deposits

Cash and cash equivalents are considered to be cash on hand, amounts in demand deposit accounts, and amounts on deposit with the Jackson County Treasurer.

State statutes authorize units of local government to deposit in the accounts of federally insured banks, credit unions, and savings and loan associations, and to invest in obligations of the U.S. Treasury, certain commercial paper, repurchase agreements, bankers acceptances, and mutual funds composed of otherwise legal investments.

2. Receivables and Payables

Fee accounts receivable are shown net of an allowance for uncollectibles, which is based on management's estimate using collection history trends.

3. Prepayments

Payments made to vendors for services that will benefit periods beyond September 30, 2006, are recorded as "prepaid items" in the accompanying statement of net assets.

4. Capital Assets

Capital assets are capitalized and reported in the operating fund, net of accumulated depreciation. The government defines capital assets as assets with an initial individual cost of at least $5,000 and an estimated useful life of at least three years. Capital assets are depreciated on the straight-line basis over the estimated useful lives of those assets, which range from five to forty years. All purchased capital assets are recorded at cost where historical records are available and at estimated historical costs where no historical records exist. Donated capital assets, if any, are valued at their estimated fair market value on the date received.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Improvements are capitalized.

5. Compensated Absences

Vacation, sick leave and personal days cannot be carried over, and are not accrued in the accompanying financial statements.

6. Unearned Revenue

Unearned revenue represents that portion of the current-year MDCH contract amount that may be carried-over to and expended in subsequent fiscal years. Such carryover is generally limited to five percent of the MDCH contract amount.

Medicaid Savings are considered local funds under the contract with MDCH, and may be spent over a period of several years in accordance with a Medicaid Reinvestment Strategy. State General Funds carried over must generally be spent in the following year.

7. Risk Management

LifeWays is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; and injuries to employees. During the year ended September 30, 2006, the entity carried commercial insurance to cover all risks of losses, except for any potential operating shortfalls under the terms of its contract with MDCH, which are covered by the Risk Reserve Internal Service Funds. LifeWays had no settled claims resulting from these risks that exceeded their commercial coverage in any of the past three fiscal years.

2. DETAILED NOTES ON ALL FUNDS

A. Deposits

At year end, the carrying amount and bank balance of LifeWays' deposits were as follows:

	Carrying Amount	Bank Balance
Demand accounts	$ 151,970	$ 312,213
Imprest cash	400	-
Jackson County Treasurer	8,886,610	8,886,610
	$ 9,038,980	**$ 9,198,823**

LifeWays' demand accounts are comprised of checking accounts with local banks with combined bank balances of $312,213, of which $211,713 was uninsured and uncollateralized.

As an Authority, LifeWays is authorized to deposit or invest in any accounts or institutions as permitted by State statutes. However, because of favorable terms, LifeWays has chosen to participate in Jackson County's investment pool, which is managed by the Jackson County Treasurer. These funds are deposited in the Treasurer's pooled accounts, and are in the name of the Jackson County Treasurer. Other County funds are also deposited in those accounts and, as such, because of the complexities of FDIC Regulation #330.8, it is not possible to readily determine the amount of insurance that would be allocated to LifeWays' deposits.

B. Due From/To Michigan Department of Community Health

For the year ended September 30, 2006, the operations of LifeWays were conducted under the terms and conditions of its contract with the MDCH.

The $349,732 due from the MDCH represents amounts due for behavioral health services and other services provided by LifeWays. The receivable balance is comprised wholly of federal and state grants.

The $372,474 due to the MDCH represents LifeWays' estimate of amounts payable to the State of Michigan for institutional care services provided by State institutions, certain amounts payable under the managed specialty supports and services contract, and the current year estimated cost settlement payable for the current year.

C. Capital Assets

Following is a summary of capital assets activity for the year ended September 30, 2006:

	Beginning Balance	Increases	Decreases	Ending Balance
Capital assets not being depreciated				
Land	$ -	$ 2,000,000	$ -	$ 2,000,000
Construction in progress	-	1,000,162	-	1,000,162
Total capital assets not being depreciated	-	3,000,162	-	3,000,162
Capital assets being depreciated				
Buildings	-	6,361,244	-	6,361,244
Computer equipment	796,093	-	-	796,093
Furnishings and other equipment	35,727	-	-	35,727
Leasehold improvements	842,947	-	-	842,947
Group homes	915,015	-	-	915,015
Total capital assets being depreciated	2,589,782	6,361,244	-	8,951,026
Less accumulated depreciation for				
Buildings	-	53,010	-	53,010
Computer equipment	681,524	77,899	-	759,423
Furnishings and other equipment	31,204	2,448	-	33,652
Leasehold improvements	281,815	30,982	-	312,797
Group homes	143,788	26,143	-	169,931
Total accumulated depreciation	1,138,331	190,482	-	1,328,813
Total capital assets being depreciated - net	1,451,451	6,170,762	-	7,622,213
Capital assets - net	$ 1,451,451	$ 9,170,924	$ -	$ 10,622,375

D. Long-term Debt

General Obligation Bonds. LifeWays uses general obligation bonds to provide funds for the acquisition and construction of major capital facilities. These bonds generally are issued as 20-year serial bonds with varying amounts of principal maturing each year. General obligation bonds currently outstanding are as follows:

	Interest Rate	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Series 1999 A Jackson County Building Authority Bonds (lease payable)	4.0 - 6.0%	$ 800,000	$ -	$ 25,000	$ 775,000	$ 50,000
Series 2006 A Jackson County Building Authority Bonds (lease payable)	4.75 - 5.0%	-	7,045,000	-	7,045,000	200,000
Mortgage Payable	7.23%	-	2,800,000	20,220	2,779,780	80,880
Subtotal		800,000	9,845,000	45,220	10,599,780	330,880
Series 2006 A Jackson County Building Authority Bonds (debt discount)		-	(42,340)	-	(42,340)	-
Total		$ 800,000	$ 9,802,660	$ 45,220	$ 10,557,440	$ 330,880

The Jackson County Building Authority leases payable are equal to the aggregate outstanding principal and interest payments due on bonds issued by the Jackson County Building Authority, that pledge the full faith and credit of the government. Those bonds were issued to finance the acquisition of five group homes for providing residential services and to purchase and renovate the administrative building.

The requirements to amortize all debt outstanding at September 30, 2006, are as follows:

Year Ending September 30,	Principal	Interest	Total
2007	$ 330,880	$ 615,714	$ 946,594
2008	380,880	569,063	949,943
2009	380,880	548,690	929,570
2010	405,880	528,318	934,198
2011	405,880	506,707	912,587
2012-2016	4,200,380	1,701,513	5,901,893
2017-2021	2,125,000	909,875	3,034,875
2022-2026	2,370,000	367,500	2,737,500
Total	**$ 10,599,780**	**$ 5,747,379**	**$ 16,347,159**

Interest Rate Swap. During the year ended September 30, 2006, the Authority entered into an interest rate swap agreement (the “Swap”) to modify interest rates in connection with its mortgage payable, which had an original issuance amount that matched the notional amount of $2,800,000. The notional amount of the swap declines according to the amortization schedule of the mortgage payable. The swap was entered into at the same time the mortgage was issued (June 30, 2006). The stated termination date of the Swap is June 30, 2013. Under the terms of the Swap, the Authority effectively pays interest calculated at a fixed rate of 7.23% to the lender, Citizens Bank.

E. Risk Reserve Fund Net Assets

At September 30, 2006, the net assets of the Risk Reserve Internal Service Funds were comprised of the following:

	Mental Health	Substance Abuse	Total
Beginning balance	$1,991,658	$ 33,630	$2,025,288
Additions	84,332	-	84,332
Deletions	(450,633)	(33,630)	(484,263)
Ending balance	**$1,625,357**	**$ -**	**$1,625,357**

Mental Health Risk Reserve

Under the terms of its managed specialty supports and services contract with MDCH, LifeWays is at risk for its operating expenses in excess of contract revenues within a specified risk corridor. In accordance with the contract, LifeWays is authorized and required to retain these funds until needed to offset actual operating losses within the risk corridor. LifeWays maximum risk exposure under the contract with MDCH is $2,793,182, based on current funding levels ($2,231,637 Medicaid, $465,311 General Fund, and $96,234 Local).

Substance Abuse Risk Reserve

Net assets in the substance abuse risk reserve are held on behalf of the Mid-South Substance Abuse Coordinating Agency. Contributions are made to the reserve by Mid-South as funding permits, and LifeWays distributes funds to Mid-South upon request. During the year ended September 30, 2006, the Authority used all available risk reserves for operations.

F. Retirement Plan

LifeWays has a single-employer defined benefit pension plan (the “LifeWays Pension Plan”) for employees of LifeWays, which provides retirement, death and disability benefits covering substantially all of LifeWays’ full-time employees. Membership of the Plan consisted of the following at October 1, 2005, the date of the latest actuarial valuation:

Retirees and beneficiaries receiving benefits	9
Terminated plan members entitled to but not yet receiving benefits	57
Active plan members	48
	114

The Plan is non-contributory for employees; by Board Resolution, LifeWays is required to contribute at an actuarially determined rate all amounts necessary to provide assets sufficient to pay for member benefits. LifeWays’ contribution to the Plan for the year ended September 30, 2006, represents 15.4% of the annual covered payroll.

The Plan is administered by a third-party insurance company. Administrative costs of the Plan are financed through investment earnings.

Plan provisions are established and amended under the authority of LifeWays’ Board. Contribution requirements are established and amended subject to Board approval.

The Plan’s annual retirement benefits cost and net retirement benefits obligation for the current year were as follows:

Annual required contribution / retirement benefit cost	$353,321
Contribution made	(353,321)
Increase (decrease) in net retirement benefit obligation	-
Net retirement benefit obligation, beginning of year	-
Net retirement benefit obligation, end of year	**$ -**

The annual required contribution for the current year was determined as part of an actuarial valuation of the Plan as of September 30, 2005, using the aggregate actuarial cost method. The actuarial assumptions included: (a) a rate of return on investments of 7%; (b) projected salary increases of 2.5% attributable to inflation; and (c) the assumption that the excess of the present value of benefits over valuation assets is spread over the average working lifetime of plan participants.

The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a four-year period. The unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis over 30 years from April 15, 1992.

Three-Year Trend Information

Year Ending	Annual Retirement Benefit Cost (ARBC)	Percentage of ARBC Contributed	Net Retirement Benefit Obligation
9/30/2004	$319,537	100.0%	$ -
9/30/2005	319,818	100.0%	-
9/30/2006	353,321	100.0%	-

GASB Statement 25 required supplementary information is presented after the Notes to Financial Statements section of this report.

G. Claims Incurred But Not Reported

LifeWays estimates the liability for contractual services provided by its contract providers that have been incurred through the end of the fiscal year, including both those claims that have been reported as well as those that have not yet been reported. Changes in the estimated liability are as follows:

Estimated liability, beginning of year	$ 884,199
Estimated claims incurred	13,267,838
Claim payments	(13,585,568)
Estimated liability, end of year	**$ 566,469**

H. Contribution to the King Trust Charitable Gift Fund

In 2002, LifeWays made contributions to the King Trust Charitable Gift Fund (the "Fund") to establish the "LifeWays Foundation" account. While LifeWays may make recommendations regarding the use of the Fund, any contributions made are irrevocable and become assets of the Fund. Since LifeWays is not the trustee of the LifeWays Foundation account, and does not exercise any control over the Fund's assets, no amounts were recorded in these financial statements at year end. The balance in the LifeWays Foundation account at September 30, 2006 was $6,332.

I. Contingencies

Under the terms of various Federal and State grants and regulatory requirements, LifeWays is subject to periodic audits of its agreements. Such audits could lead to questioned costs and/or requests for reimbursement to grantor or regulatory agencies. Management does not consider such amounts to be significant.

As is the case with other entities, LifeWays faces exposure from potential claims and legal proceedings involving environmental and other matters. No such claims or proceedings have been asserted as of September 30, 2006.

J. Commitments

At September 30, 2006 LifeWays had construction commitments outstanding of $710,821.

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GASB REQUIRED SUPPLEMENTARY INFORMATION

LifeWays
GASB Statement 25 Required Supplementary Information
Employee Retirement System

Schedule of Funding Progress

Actuarial Valuation Date Oct. 1	(1) Actuarial Value of Assets	(2) Actuarial Accrued Liability (AAL) Entry Age	(3) Unfunded AAL (UAAL) (2-1)	(4) Funded Ratio (1/2)	(5) Covered Payroll	(6) UAAL as a % of Covered Payroll (3/5)
1996	$ 891,391	$ 1,846,011	$ 954,620	48.3 %	$ 2,649,503	36.0 %
1997	1,382,713	1,814,743	432,030	76.2	2,840,510	15.2
1998	1,445,894	2,222,694	776,800	65.1	2,464,317	31.5
1999	1,809,122	2,380,312	571,190	76.0	2,576,654	22.2
2000	2,236,469	2,793,508	557,039	80.1	2,271,312	24.5
2001	2,157,775	2,349,783	192,008	91.8	2,337,520	8.2
2002	2,214,182	2,708,063	493,881	81.8	1,948,381	25.3
2003	2,775,533	3,617,533	842,000	76.7	1,940,994	43.4
2004	3,401,945	3,975,950	574,005	85.6	2,197,653	26.1
2005	3,844,328	4,417,267	572,939	87.0	2,294,787	25.0

Schedule of Employer Contributions

Fiscal Year Ended Sept. 30	Annual Required Contribution	Annual Actual Contribution	Percentage Contributed
1997	$ 283,998	$ 283,998	100.0 %
1998	230,891	230,891	100.0
1999	303,890	303,890	100.0
2000	280,974	280,974	100.0
2001	255,090	255,090	100.0
2002	310,429	310,429	100.0
2003	336,528	336,528	100.0
2004	319,537	319,537	100.0
2005	319,818	319,818	100.0
2006	353,321	353,321	100.0

SUPPLEMENTARY INFORMATION

LifeWays
Combining Statement of Net Assets - Internal Service Funds
September 30, 2006

	Mental Health Risk Reserve		Substance	
	Medicaid	General Fund	Abuse Risk Reserve	Totals
Assets				
Cash and cash equivalents	$ 1,509,743	$ 115,614	$ -	$ 1,625,357
Liabilities				
Unearned revenue	-	-	-	-
Net assets				
Restricted for contract losses	$ 1,509,743	$ 115,614	$ -	$ 1,625,357

LifeWays
Combining Statement of Revenue, Expenses and Changes in Net Assets - Internal Service Funds
For the Year Ended September 30, 2006

	Mental Health Risk Reserve		Substance	
		General	Abuse	
	Medicaid	Fund	Risk Reserve	Totals
Operating revenue				
Charges for services	$ -	$ -	$ -	$ -
Non-operating revenue				
Interest income	76,203	8,129	-	84,332
Net income before transfers	76,203	8,129	-	84,332
Transfers out	(190,866)	(259,767)	(33,630)	(484,263)
Change in net assets	(114,663)	(251,638)	(33,630)	(399,931)
Net assets, beginning of year	1,624,406	367,252	33,630	2,025,288
Net assets, end of year	$ 1,509,743	$ 115,614	$ -	$ 1,625,357

LifeWays
Combining Statement of Cash Flows
Internal Service Funds
For the Year Ended September 30, 2006

	Mental Health Risk Reserve		Substance	
	Medicaid	**General Fund**	**Abuse Risk Reserve**	**Totals**
Cash flows from operating activities				
Cash payments to vendors and others	$ -	$ -	$ -	$ -
Cash received from interfund services	-	-	-	-
Net cash used in operating activities	-	-	-	-
Cash flows from non-capital financing activities				
Transfers out	(190,866)	(259,767)	(33,630)	(484,263)
Cash flows from investing activities				
Interest received	76,203	8,129	-	84,332
Net increase (decrease) in cash and cash equivalents	(114,663)	(251,638)	(33,630)	(399,931)
Cash and cash equivalents, beginning of year	1,624,406	367,252	33,630	2,025,288
Cash and cash equivalents, end of year	$ 1,509,743	$ 115,614	$ -	$ 1,625,357
Reconciliation of operating income to net cash provided by operating activities				
Operating income	$ -	$ -	$ -	$ -
Adjustments to reconcile operating income to net cash provided by operating activities:				
Changes in assets and liabilities:				
Unearned revenue	-	-	-	-
Net cash provided by operating activities	$ -	$ -	$ -	$ -

INTERNAL CONTROL AND COMPLIANCE

REHMANN ROBSON
Certified Public Accountants
A member of THE REHMANN GROUP
an independent member of BAKER TILLY INTERNATIONAL

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

December 15, 2006

The Board of Directors
LifeWays
Jackson, Michigan

We have audited the financial statements of the business-type activities, the major fund, and the aggregate remaining fund information of ***LifeWays*** as of and for the year ended September 30, 2006, which collectively comprise LifeWays' basic financial statements as listed in the table of contents, and have issued our report thereon dated December 15, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered LifeWays' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be a material weakness. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether LifeWays' basic financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the LifeWays Board, management, others in the organization, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Rehmann Robson

REHMANN ROBSON
Certified Public Accountants
A member of THE REHMANN GROUP
an independent member of BAKER TILLY INTERNATIONAL

December 15, 2006

To the Board of Directors of the
LifeWays
Jackson, Michigan

We have audited the financial statements of LifeWays for the year ended September 30, 2006, and have issued our report thereon dated December 15, 2006. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility Under Auditing Standards Generally Accepted in the United States of America

As stated in our engagement letter dated September 26, 2006, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute, assurance that the financial statements are free of material misstatement and are fairly presented in accordance with accounting principles generally accepted in the United States of America. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

As part of our audit, we considered the internal control of LifeWays. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

Significant Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we advised management about the appropriateness of accounting policies and their application. The significant accounting policies used by LifeWays are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. We noted no transactions entered into by LifeWays during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

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- Management's estimate of the useful lives of depreciable fixed assets is based on the length of time it is believed that those assets will provide some economic benefit in the future. We evaluated the key factors and assumptions used to develop the useful lives of those assets in determining that they are reasonable in relation to the financial statements taken as a whole.

- Management's estimate of the liability for claims incurred but not reported. We evaluated the key factors and assumptions used to develop the amount of the liability in determining that it is reasonable in relation to the financial statements taken as a whole.

- Management's estimate of its maximum risk exposure under its contract with MDCH. This estimate is the basis for determining whether the amount in the risk reserve internal service fund is within allowable limits. We evaluated the key factors and assumptions used to develop LifeWay's Risk Management Plan in determining that it is reasonable in relation to the financial statements taken as a whole.

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on **LifeWays'** financial reporting process (that is, cause future financial statements to be materially misstated). In our judgment, none of the adjustments we proposed, whether recorded or unrecorded by **LifeWays**, either individually or in the aggregate, indicate matters that could have a significant effect on **LifeWays**' financial reporting process.

In addition, the attached schedule summarizes uncorrected misstatements of the financial statements. Management has determined that their effects are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the governmental unit's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as LifeWays' auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no difficulties in dealing with management in performing our audit.

This letter and the accompanying memorandum are intended for the use of the Board of Directors, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

Rehmann Robson

LifeWays

Comments and Recommendations

For the Year Ended September 30, 2006

During our audit we became aware of certain issues regarding internal control and financial reporting. This memorandum summarizes our comments and suggestions regarding these matters. This memorandum does not affect our report dated September 30, 2006 on the financial statements of LifeWays.

Subsidiary Records for Balance Sheet Accounts

During the audit, various schedules were requested from management as of September 30, 2006. Neither the subsidiary records for client fees accounts receivable nor the subsidiary records for fee for service claims payable had been retained. As a result, additional procedures were required to reconcile subsequent reports to the general ledger balances as of September 30, 2006. We recommend that the Authority retain year end reports for all general ledger accounts which are supported by subsidiary records.

Journal Entry Review

During our review of internal controls over journal entry processes, we noted that journal entries were not initialed or signed by someone other than the preparer as a check for journal entry completeness and accuracy. We recommend that all journal entries be reviewed and initialed by an individual other than the preparer who is competent to understand that nature and purpose for the transaction.

Hillsdale County Appropriation

The Authority is carrying a receivable of $11,262 (and has for several years) representing amounts due from Hillsdale County. It is unclear as to whether the Authority and County are in agreement as to this receivable/payable. As such, we recommend that the Authority work with the County to resolve this difference and to adjust the County's general ledger accordingly.

* * * * * *

LifeWays

Schedule of Adjustments Passed (SOAP)
For the September 30, 2006 Audit

In accordance with the provisions of SAS 89, *Audit Adjustments*, we have prepared the following schedule of proposed audit adjustments, which we believe are immaterial both individually and in the aggregate. Also in accordance with SAS 89, we are providing this schedule to both management and the audit committee to receive their assurance that they agree that the amounts listed below are not material to the financial statements, either individually or in the aggregate, and do not need to be recorded.

	Effect of Passed Adjustment - Over(Under)Statement				
	Assets	Liabilities	Beginning Fund Balance	Revenue	Expenses/ Expenditures
General Fund					
Unreconciled variance in cash	(20,896)	-	(20,896)	-	-
Amount recorded as receivable from Hillsdale County for prior year's appropriations which is not agreed to by the County	11,262	-	11,262	-	-
	(9,634)	-	(9,634)	-	-